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No. 87-178

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1987

PACIFIC GAS AND ELECTRIC COMPANY,
Petitioner,

v.

PUBLIC UTILITIES COMMISSION OF
THE STATE OF CALIFORNIA, et al.,
Respondents.

BRIEF OF RESPONDENT BASIC AMERICAN FOODS, INC. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA SUPREME COURT

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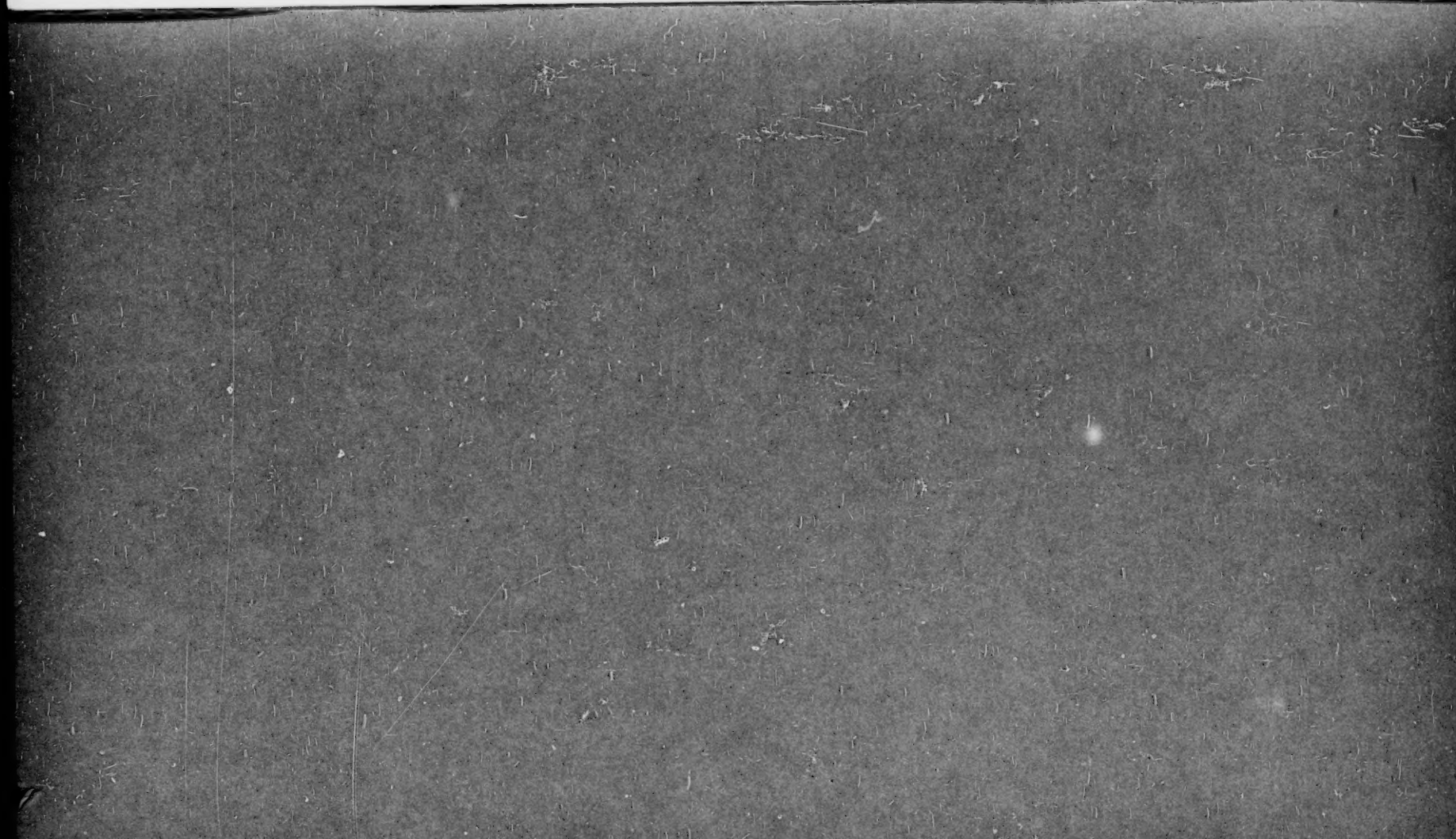

QUESTION PRESENTED

Whether the California Public Utilities Commission (CPUC) acted consistently with the provisions of the Public Utility Regulatory Policies Act of 1978 (PURPA) in construing the price terms of a long-term standardized power purchase agreement, previously adopted by the CPUC in implementing its mandate under PURPA, to require payment of prices based on forecasts of long-run avoided costs as of the date the agreement was negotiated even though such long-run prices may now exceed current estimates of avoided costs.

RULE 28.1 STATEMENT

Basic American Foods, Inc. is a privately held corporation having no parent and no non-wholly owned subsidiaries or affiliates.

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BRIEF OF RESPONDENT BASIC AMERICAN FOODS, INC. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA SUPREME COURT

Respondent Basic American Foods, Inc. (Basic) submits this brief in opposition to the Petition for Writ of Certiorari filed by Petitioner Pacific Gas and Electric Company (PGandE).

STATEMENT OF THE CASE

This case involves the interpretation of agreements entered into pursuant to regulations issued by the California Public Utilities Commission (CPUC). On September 3, 1980, the CPUC instituted regulatory proceedings on the subject of the purchase by electric utilities of power generated by independent entities. These proceedings were designed to carry out the statutory policies of the Public Utility Regulatory Policies Act of 1978 (PURPA) and its California counterpart codified as Chapter 7 of the California Public Utilities Code §§ 2801-2824. These policies were to promote competition, conservation, and decentralization in electric power generation through the encouragement of

cogeneration projects and small alternative fuel electric generation facilities.

The CPUC chose as the vehicle for carrying out policy in this area the development of Standard Offer contracts pursuant to which California electric utilities would be required to purchase electricity from qualifying facilities (often referred to as QFs). In the first two decisions issued under its regulatory proceedings, the CPUC established Standard Offers 1 through 3 which governed the purchase of electric power at prices based on short-run avoided costs. *See*, D.82-01-103, 8 C.P.U.C. 2d 20 (1982); D.82-12-120, 10 C.P.U.C. 2d 553 (1982). The CPUC also recognized that short-run avoided costs were prone to sudden and dramatic changes in response to volatile market conditions. Because of such contract price uncertainty, QFs experienced great difficulty arranging financing for their projects. In order fully to carry out the policy of the federal and California statutes by providing QFs with a level of price certainty that would facilitate project financing, the CPUC determined that it must develop and implement promptly a Standard Offer with long-run as opposed to short-run pricing provisions. D.83-09-054 (1983), (Petitioner's Appendix at A-4-5).[1]

In September 1983, following lengthy negotiations involving Petitioner PGandE, the other major California electric utilities, representatives of consumer and QF interests, and the CPUC staff, the CPUC adopted interim Standard Offer 4 (interim SO4). Interim SO4, as agreed to by PGandE and the other participants in the negotiations, provided for the purchase of electric power for terms of from 15 to 30 years. Like the earlier short-run Standard Offers, the pricing provisions involved both "capacity" and "energy" elements.[2]

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[1]Subsequent citations to Petitioner's Appendix will be indicated by the letter A followed by the appropriate page in the Appendix.

[2] The capacity pricing elements specified in interim SO4 (which were essentially incorporated from the earlier Standard Offer 2) were calculated to equal "avoided shortage costs, related to the peaking firm capacity the utility can avoid (based on the rental value of a combustion turbine)." D.83-09-054 (1983), (A-19). The energy elements were

In general, firm capacity prices would be fixed and level over the entire term of the contract while energy prices could be fixed only for the first 10 years of operations. The combination of fixed energy and firm capacity payments produced the intended result that a QF could project long-term revenues at the time it signed a contract pursuant to interim SO4 and base its plans and financing on those revenue projections. As the CPUC noted with regard to energy payments:

> The QF project must be on line within 5 years from the date the agreement is executed. However, the QF agrees to the payment stream, based on the forecast, when the contract is signed. This means utilities must have a 15-year forecast when the contract is signed to allow for a maximum 5-year hiatus before operation and payments start after contract execution.

D.83-09-054 (1983), (A-19).

Unfortunately, there were inadvertent omissions in certain of the tables in the agreements executed by QFs pursuant to interim SO4. For example, the CPUC's September 1983 decision approving interim SO4 specified that, subject to further order, interim SO4 would be in effect for at least six months but no more than two years. D.83-09-054 (1983), (A-44). The projected energy prices in Table B-1 of the interim SO4 agreement prepared by PGandE, however, covered only the years 1983 through 1997 so that the 15-year forecast referred to by the CPUC was short from its inception by at least one and possibly three years.[3] Similarly,

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based on "a forecast of utility's marginal energy cost." D.83-09-054 (1983), (A-19, n.3).

[3] As prepared by PGandE, Table B-1 provided energy prices from 1983 to 1997. If interim SO4 had remained available only for the minimum anticipated six months, a QF executing an agreement in early 1984 that required the full five years to commence operations would need fixed energy price estimates until early 1999. If the agreements were to remain available for the maximum two years contemplated, a QF could execute a contract as late as September 1985 and its contract would require fixed energy price estimates extending until September 2000.

Table E-2 was simply carried over from Standard Offer 2 and provided firm capacity prices only for projects that established their ability to supply firm power between 1982 (one year before interim SO4 was even approved) and 1987, instead of between 1983 and 1990—the years when the interim SO4 projects could actually begin firm operations.

In August 1984, at the request of QF interests and with no objection from PGandE, the CPUC acted to extend certain interim SO4 options that otherwise would have expired in September 1984. In April 1985, the CPUC suspended prospectively the availability of interim SO4, and it is now in the process of replacing it with a permanent long-run Standard Offer.

In the meantime, however, the inadvertent omissions in the tables attached to interim SO4 agreements became apparent. Respondent Basic, for example, had signed a contract in November 1984 to supply PGandE with energy and capacity from a 120 megawatt cogeneration project—designed to produce heat that would be used in Basic's food dehydration plant and to generate electricity from the waste heat—to be built in King City, California.[4] Basic's original plan was to commence operations by 1987. Because of delays in obtaining needed siting permits, however, it became apparent by 1986 that Basic would not be able to commence deliveries of power until 1988. QFs which had signed contracts with the other major California electric utilities had asked for and obtained clarifications extending Tables B-1 and E-2. PGandE, however, refused Basic's request for such clarification and took the position that unless Basic's cogeneration facility commenced operation before 1988, the contract would provide no fixed capacity prices and less than the full ten years of forecasted energy prices.[5] In the absence of such specified prices, PGandE

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[4] Basic represents the type of QF that PURPA was designed to encourage since its large thermal heat needs provide a significant opportunity for efficient cogeneration.

[5] Basic's major competitor initiated a program to develop a similar 120 megawatt cogeneration project. Although Basic and its competitor executed similar interim SO4 contracts, PGandE agreed to extend the competitor's Table E-2 to provide firm capacity prices, notwithstanding

would pay Basic only "reasonable" prices based on short-run avoided costs at the time of delivery.[6]

In three orders issued between October and December 1986 (A-126 through A-148), the CPUC considered applications by Basic and similarly situated QFs seeking clarification of their entitlement to fixed price certainty under their interim SO4 contracts and correction of the inadvertent omissions in the appended tables. Rejecting PGandE's arguments as inconsistent with the purpose and language of interim SO4 and with the intent of the parties in negotiating the long-run contracts, the CPUC ordered PGandE to do what was required by the terms of the agreement and what the other California electric utilities had agreed to do voluntarily.

In particular, the CPUC held that the methodology used to generate the firm capacity prices of Table E-2 should be carried forward to calculate prices for projects whose capacity became available in 1988, 1989, and 1990—thereby accomplishing what PGandE itself had previously urged was a "ministerial" task in seeking a similar adjustment to the firm capacity price table in Standard Offer 2, the very same table that was incorporated into interim SO4. (A-134, n. 11). Because there was no similar methodology readily available in the case of energy prices, the CPUC simply ordered PGandE to extend the 1997 price through the year 2000, thereby ensuring the full 10-year fixed payment stream contemplated by interim SO4.[7] The CPUC considered

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that the competitor would not begin deliveries until 1988, but refused Basic's request for similar treatment.

[6] To put PGandE's position in perspective, it should be recognized that PGandE perceives QFs to be competitors. While QFs do not compete with PGandE in retail sales of electricity, QF power plants supplant utility power plants which constitute a significant portion of the utility's rate base upon which a utility's rate of return is applied.

[7] The CPUC also rejected PGandE's argument concerning "as-delivered" capacity and ordered the 1997 price in Table D-2 extended for the years 1998-2000. This part of the CPUC order is not in issue since, as PGandE concedes, the interim SO4 agreement otherwise produces the same result.

and rejected PGandE's contention that it was ordering "new" prices and found that extension of the tables was necessary to construe the agreement logically and conform the interim SO4 agreement to the purposes underlying its adoption and to the parties' intent.[8]

On April 30, 1987, the California Supreme Court denied PGandE's petition for a writ of review of the CPUC orders. Under California law, the court's action constituted a rejection on the merits[9] of PGandE's claims presented to the court that the CPUC's interpretation of the interim SO4 agreements violated earlier regulatory pronouncements, incorrectly applied California law, and thereby established prices higher than those required to satisfy the avoided costs standard mandated by Section 210(b) of PURPA. By its present Petition for Writ of Certiorari, PGandE essentially asks this Court to reverse the California Supreme Court's rulings on these issues.

REASONS FOR DENYING THE WRIT

No substantial federal question is raised in the Petition. The CPUC decisions at issue involve no more than the agency's interpretation of the terms of contracts entered into pursuant to interim SO4. In its simplest terms, the Petition argues that the CPUC, the agency best suited to make the determination at issue, acted inconsistently with PURPA by incorrectly interpreting the agreements under state law. In fact, the underlying issues of state

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[8] In connection with extending Table E-2, the CPUC stated that it was "[C]onstruing the express terms to give them their clear and logical effect." (A-135). In extending Tables B-1 and D-2, the CPUC stated, "The intent of the parties in placing Table B-1 into [interim SO4] was to provide for energy price certainty for up to ten years for each QF signing under that contract . . . The same is true for Table D-2, which represents as-available capacity prices." (A-146).

[9] The California Supreme Court's denial of a petition for a writ of review of an order from the CPUC constitutes a decision on the merits for purposes of *res judicata*. *See*, *Consumers Lobby Against Monopolies v. Public Utilities Commission*, 25 Cal.3d 891, 901, 603 P.2d 41, 160 Cal. Rptr. 124 (1979).

law were decided correctly and would, in any event, not be properly reviewed in this Court. Furthermore, by its very terms, the Standard Offer that led to the agreements at issue was interim in nature, subsequently suspended, and unique to California. No question of national application or importance is presented, nor is the decision below in conflict with the decision of any other court. At most, the decision can be argued to raise by strained implication an issue previously determined by this Court not to present a substantial federal question when it dismissed the appeal in *Consolidated Edison Co. v. Public Service Commission*, 470 U.S. 1075 (1985).

A. Petitioner Has Misstated The Question Presented

PGandE misstates the nature of the proceedings below and incorrectly frames the question presented by repeatedly characterizing the CPUC's actions as establishing "new" prices added to existing interim SO4 agreements. Thus Petitioner concludes that the federal question involved is whether the CPUC's adoption of "new" prices is in conflict with the avoided costs standard of PURPA, in this process comparing the "avoided costs" forecasts negotiated in 1983 and embodied in the interim SO4 agreement with estimates of "avoided costs" presented by PGandE in 1986 when the CPUC construed the interim SO4 agreements. PGandE ignores the CPUC's rejection of PGandE's repeated allegations that "new" prices were being added and its conclusion that the extension of the price tables simply made available to QFs the fixed price certainty that was the "crux" of interim SO4 and upon which the QFs had substantially relied. (A-129).

The question presented, properly framed, is whether the CPUC acted consistently with PURPA and the regulations of the Federal Energy Regulatory Commission (FERC) thereunder when it construed the terms of a long-term standard offer power purchase agreement to require payment of prices based on negotiated forecasts of long-run avoided costs that were determined when the agreement was made available to QFs, even if such prices may for the moment exceed later estimates of avoided costs. So stated, it is apparent from the discussion that follows that the federal question is insubstantial and that the issue was properly decided below.

The FERC regulations give the CPUC wide latitude in implementing PURPA. 18 C.F.R. § 292.401(a) (1987). This latitude includes the authority to adopt standard offer power purchase agreements for specified terms. 18 C.F.R. § 292.304(d)(2) (1987). Furthermore, in determining "avoided costs," the FERC regulations direct the CPUC to consider various factors, one of which is "the terms of any contract or other legally enforceable obligation including the duration of the obligation. . . ." 18 C.F.R. § 292.304(e)(2)(iii) (1987). The CPUC is expressly authorized to implement the FERC regulations by establishing prices based on avoided cost estimates in effect at the time a contract is signed. 18 C.F.R. § 292.304(d)(2) (1987). If contracts of specified terms are used, "the rates for such purchases do not violate [PURPA] if the rates for such purchases differ from avoided costs at the time of delivery." 18 C.F.R. § 292.304(b)(5) (1987).

Both state law and the FERC regulations implementing PURPA authorize the CPUC to resolve questions involving the obligations of utilities to purchase QF power. *Compare*, Cal. Pub. Util. Code §§ 701, 702, 1702, 2821 (West 1975 & Supp. 1987) *with* 18 C.F.R. § 292.401(a) (1987). PGandE's contention that, in extending the tables at issue, the CPUC added "new" prices challenges only the CPUC's application of state law in a factual inquiry undertaken to interpret the meaning of the agreements in light of the parties' intent and the purposes and policies embodied in the original CPUC decision approving interim SO4.

The CPUC found that the parties had intended and interim SO4 required that fixed price certainty would be available to all QFs that had executed the agreements and were able to commence operations within the agreement's five year deadline. It was well understood by all parties involved in the proceedings that led to interim SO4, including PGandE, that actual avoided costs at the time of delivery would, over the term of the resulting agreements, depart from the avoided costs that were forecasted in 1983. D.83-09-054 (1983), (A-6).

Moreover, PGandE's unsupported and grossly inaccurate assertion that the three decisions will result in a $1 billion ratepayer subsidy to QFs is misleading and misses the point entirely. The interim SO4 agreements are for 15-30 year terms and there

simply is no way to know whether over the long-term interim SO4 prices will prove to be higher or lower, in the aggregate, than avoided costs at the time the power is delivered.[10] The point is that the interim SO4 prices were based on forecasts of long-run avoided costs at the outset, not short-run costs calculated at various times during the term of the agreements. Whether the original forecast adopted in interim SO4 may now exceed estimates of current avoided costs is irrelevant since such a risk was contemplated and expressly provided for at the outset and such a situation is expressly permitted under the FERC regulations.

B. The Federal Question Raised Below Is Not Only Insubstantial But Also Unique And Unlikely To Recur

Each state regulatory authority is charged under PURPA with the duty of implementing the rules promulgated by the FERC. Section 210(f)(1), 16 U.S.C. § 824a-3(f)(1) (1987). The state regulatory authority is given wide latitude in how it elects to implement the FERC rules. 18 C.F.R. § 292.401(a) (1987). Moreover, the FERC rules do not specify what avoided costs will be but instead instruct the state regulatory authority to determine avoided costs by evaluating "to the extent practical" the factors listed in 18 C.F.R. § 292.304(e) (1987). Thus, the implementation of PURPA contemplates a wide diversity both in the methods chosen by the state regulatory authorities to implement

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[10] In his recent testimony before the FERC submitted March 27, 1987, Commissioner Stanley Hulett, President of the CPUC, emphasized this very point by stating:

> The CPUC believes that any overpayments that may occur in the early years of these [interim SO4] contracts has to be put in a proper context. We agree that, when compared to short-run avoided costs in 1990, QFs under the interim long-run standard offer will be receiving payments in excess of short-run avoided costs. However, the CPUC believes that this is not the correct standard of comparison. These QFs are long-run resources, with contract lengths of up to thirty years. To compare a long-run resource with short-run avoided costs in one year is incorrect and misleading; the proper standard is to view these contracts over their life and, on that basis, these QFs could be some of the best deals utilities have.

PURPA's requirements and in the valuation of avoided costs within each state.

No substantial question of national importance involving the proper implementation of PURPA by state regulatory authorities is raised that merits this Court's review. This is so because the scope of the CPUC's action is narrow, limited to resolving a state law question of contract interpretation. The omission in the tables attached to interim SO4 agreements necessitated an interpretation by the CPUC to clarify whether QFs beginning operations after 1987 but within the agreements' five year deadline were entitled to the same fixed price certainty for energy and capacity prices as QFs that had executed the same agreements but commenced operations before 1988, notwithstanding the failure of the appended price tables to contain the full range of fixed prices necessary to provide all QFs with such uniform treatment.

No recurring issue or broad question of federal policy under PURPA is involved. The likelihood that either the CPUC or any other state regulatory authority will be faced in the future with a need to interpret a similar agreement and resolve conflicting interpretations over the level of price certainty available under that agreement is extremely remote and inconsequential to the implementation of a national energy policy under PURPA. The issue addressed by the CPUC is neither one of national application nor importance. Furthermore, the interpretation reached by the CPUC in this case is entirely consistent with PURPA's policy of encouraging private energy development.

C. The Decision Below Affirms The CPUC's Resolution Of A Fact Specific Inquiry Undertaken By The Agency Best Suited To Make That Determination

Any validity to the Question Presented in the Petition must hinge on PGandE's contention that the interim SO4 power purchase agreement, as originally approved by the CPUC, does not permit the construction given to it by the CPUC. Thus, Petitioner invites this Court to substitute its own judgment for that of the CPUC and reject the CPUC's construction of the agreement as affirmed by the California Supreme Court's denial of review. Certiorari should not be granted simply to review

evidence and discuss specific facts. *United States v. Johnston*, 268 U.S. 220, 227 (1925).

No substantial federal question is presented when the question involves solely the application of state law by a state regulatory authority charged with the duty of implementing a federal statute in a manner that it deems appropriate in light of its experience and expertise. Such expertise has been vested in the CPUC. The application of such expertise by the state regulatory agency that was responsible for originally implementing the contracts involved and is thereby best suited to resolve the matters at issue simply does not warrant the review of this Court.

D. No Conflict Exists In The Decisions Of State Courts That Justify This Court's Review Of The Decisions Below

Petitioner incorrectly asserts that a conflict in the application of federal law exists between this case and two inconsistent state court decisions, *Consolidated Edison Co. v. Public Service Commission*, 63 N.Y. 2d 424, 472 N.E. 2d 981, 483 N.Y.S. 2d 153 (1984), *appeal dismissed*, 470 U.S. 1075 (1985) and *Kansas City Power and Light Co. v. State Corp. Com'n*, 234 Kan. 1052, 676 P.2d 764 (1984). Petition at 14. No such conflict exists because both of these cited cases are inapposite to the legal issue presented herein.

Both *Kansas City Power* and *Consolidated Edison* involve the adoption of prices under state law independent from PURPA that were intended to depart from and at times exceed the avoided cost standard of PURPA. In this case, the CPUC never intended to depart from PURPA and adopt under state law prices that exceed avoided costs. The prices originally adopted in the long-term interim SO4 agreement are negotiated estimates of long-run avoided costs that are entirely consistent with PURPA and the implementing FERC regulations. That the long-run avoided costs originally adopted in interim SO4 may exceed PGandE's estimate of avoided costs determined at some later time is expressly permitted under, and thus does not violate the avoided costs standard required by, PURPA and the implementing FERC

regulations. Thus, the purported conflict raised by PGandE is nonexistent.[11]

In any event, in dismissing the appeal in *Consolidated Edison*, this Court concluded that no substantial federal question was presented by a state court decision expressly holding that PURPA does not preempt the field, but allows states to promote greater QF development by adopting prices that exceed the avoided costs standard established under federal law. *A fortiori*, no substantial federal question is presented when, even to reach this issue, this Court would have to examine and reverse the CPUC's decisions as to the intent of the parties to the interim S04 negotiations and the proper interpretation of interim S04 agreements under state law.

CONCLUSION

For all the reasons stated above, the Petition for Writ of Certiorari should be denied.

August 25, 1987

Respectively submitted,

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[11] Given that the CPUC did not purport to adopt prices in excess of the avoided costs standard of PURPA, there is no need to consider whether California Public Utilities Code § 2821 would independently authorize the CPUC to adopt "equitable charges" in excess of such costs. Had the CPUC expressly relied on state law to adopt higher than avoided cost prices, then the conflict with *Kansas City Power* that PGandE strains to construct might exist.